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SMALL BUSINESS GUIDE TO THE
DEFENSE ACQUISITION REGULATION

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This guide explains, in simple language, the basic purchasing rules and regulations of the Department of Defense. It is not intended to provide assistance in locating sales opportunities, although the Appendix lists several excellent sources of marketing information.

Every defense purchasing office has at least one person called a small and disadvantaged business utilization specialist. This specialist can provide information about contracting opportunities with that office and can also provide assistance when problems arise during the performance of a contract.

1. INTRODUCTION

HOW THIS GUIDE CAN HELP YOU

Small businesses play an important role in developing and supplying the goods and services needed to preserve our national security. Small businesses, including those owned by socially and economically disadvantaged persons and those owned by women, are encouraged to do business with the Department of Defense (DoD).

Selling to DoD is different from selling to your commercial customers. You, the contractor, must abide by certain rules. If you don't, you may not get the contracts, or, if you do get the business, you may find yourself in unnecessary trouble. The "bible" of defense procurement is a voluminous set of regulations called the Defense Acquisition Regulation (DAR). To be a successful defense contractor, you must have a working knowledge of the DAR.

The DAR is published in loose-leaf form. Defense Acquisition Circulars (DACs) are issued, as needed, to promulgate changes in the DAR between editions. Many public libraries subscribe to the DAR. DoD purchasing offices maintain copies to which you may refer. A subscription to the DAR will provide you with the latest edition of the regulation, with all changes to date, plus any changes for the next year. Subscriptions may be made through the Superintendent of Documents, U.S. Government Printing Office, Washington, D. C. 20402. The current annual subscription rate as of February 1983 is \$115.00. (A subscription form is included on page 47.)

This guide will introduce you to the basics of defense contracting set forth in the DAR. The DAR contains policies and procedures for purchases of products and services ranging from everyday household items to the most advanced weapon systems. Yet most DoD contracts are entered into and performed under fairly standard procedures. This is especially true of the procurements that small businesses are most likely to perform.

While explaining the buying rules of the DoD, the guide will also point out the pitfalls awaiting the unwary small business contractor. Read it carefully and understand what's expected of you. Don't fool yourself. If you can't perform the job within the rules, then the Government won't get the product it needs, and you may find yourself in financial straits as well.

Remember, to be a successful defense contractor, you must understand the basic rules.

CONTENTS OF THIS GUIDE

This guide is not a marketing manual. Rather, it is designed to help you understand the DAR by offering simple explanations of the basics of doing business with DoD. The next chapter of this guide is an overview of the DAR and explains the major differences between doing business in the private sector and doing business with DoD. Chapter 3 introduces four basic principles underlying DoD's contracting process. Chapter 4 covers DoD's procedures for soliciting suppliers and its various methods for entering into contracts, with special emphasis on small business aspects. Chapter 5 examines the types of contracts used by DoD, commonly used contractual clauses, and procedures you may encounter during the course of the contract. Additional sources of information that may be helpful to small business contractors are provided in the appendix. To assist you in locating relevant material in the DAR, references to DAR provisions are placed in the margins of the guide.

A WORD OF CAUTION: This guide is not a substitute for any requirement or provision of the DAR. It does not provide total coverage of any topic. Its coverage is limited to those regulations and procedures most frequently encountered by DoD's small business suppliers. If an unusual or complex contracting problem arises, you should refer to the exact language of the DAR, and you may also want to seek legal advice.

2. BACKGROUND INFORMATION

OVERVIEW OF THE DAR

The DAR is the primary instruction governing all defense contracting. It contains DoD procurement policies as well as many detailed procedural and administrative requirements.

The DAR is over 2,000 pages long. It is divided into 26 sections (equivalent to chapters) and has 18 appendices, 2 manuals, and 5 supplements.

Each section of the DAR deals with a separate aspect of procurement. Section I contains general policies and principles relating to DoD contracting. Sections II and III deal with the two authorized methods of Government procurement: formal advertising and negotiation. The remaining sections deal with various aspects of procurement, such as labor policies, cost principles, patents, and standard clauses.

Much of the material in the DAR is intended to cover the wide variety of DoD procurements. For example, even though there are over 500 pages of standard clauses and 300 pages of standard forms, only a relatively few will be used in any single procurement.

Certain DAR policies and procedures apply only to small businesses. They include programs designed to match small business capabilities with DoD needs and procurement techniques designed to help small businesses with individual procurements and subcontracting opportunities. All such small business aids are addressed in this guide.

MAJOR DIFFERENCES BETWEEN COMMERCIAL AND GOVERNMENT PRACTICES

While there are similarities between doing business in the private sector and doing business with DoD, Government contracting has some unique aspects you should know about.

First, DoD conducts its business through certain authorized agents, usually called Contracting Officers. You may be dealing with more than one Contracting Officer. Procurement Contracting Officers (PCOs) enter into contracts. Administrative Contracting Officers (ACOs) supervise contract

performance. Sometimes the PCO and ACO will be the same person. Contracting Officers have varying degrees of authority to obligate DoD, and DoD is not bound to reimburse you for costs resulting from acts beyond the limits of a Contracting Officer's authority. Therefore, you should never hesitate to make sure of the authority of the persons with whom you're dealing.

Second, unlike your commercial customers, DoD has the unilateral right to revise its contracts. While you are entitled to equitable adjustments in price and/or delivery time resulting from such revisions, you must continue performance of the contract as changed.

Third, DoD obtains extensive audit and work surveillance rights under its contracts. You are obligated to maintain and retain certain contract records and to submit these to audit on demand. Should these audits reveal a failure to conform to contract requirements, you may be subject to penalties or price adjustments.

Fourth, DoD uses its procurement program as a vehicle for numerous national, social and economic objectives. As a prospective contractor, you must recognize that participation in DoD contracts will require varying degrees of cooperation and compliance with other governmental goals and objectives.

Fifth, under certain types of contracts, there are limitations on the amount of profit which you can earn and on the amounts and types of costs you may recover.

Finally, DoD has an absolute right to terminate all or any part of your contract at any time. Your contract may be terminated either for the convenience of DoD, whenever the need dictates, or for default if your performance is unsatisfactory.

3. BASIC CONTRACTING PRINCIPLES

DAR
REFERENCE

Before looking at the DAR in detail, you should be aware of four basic principles underlying DoD's contracting process.

First, to ensure reasonable prices, contracts are awarded competitively whenever possible. This practice reflects the theory that free and open competition results in fair and reasonable prices. Open competition also avoids favoritism by assuring that all qualified suppliers have the opportunity to sell to the Government. 1-300.1

In most instances, open competition for Government procurements is best accomplished by the formal advertising method. The DAR requires DoD purchases to be made by formal advertising whenever feasible. When formal advertising is not feasible, DoD may negotiate with potential contractors for the items needed. Even when negotiated, the DAR requires that the maximum possible competition be sought. When competition is not possible, the DAR requires that the reasonableness of a price be established by analysis of the price or of the probable costs of contract performance. 2-102.1
3-101
3-807

Second, contracts are awarded only to contractors determined to be responsible. Regardless of the procurement method used, the DAR provides that the Contracting Officer must assure that a prospective contractor is responsible before the contract is awarded. This means that you must: 1-900
thru
1-907

- (1) have, or be able to obtain, adequate financial resources,
- (2) be able to comply with the delivery requirements,
- (3) have a satisfactory record of performance,
- (4) have a satisfactory record of integrity, and
- (5) be otherwise qualified and eligible to receive an award.

These determinations are generally based on the Contracting Officer's evaluation of contractors' data and records of prior performance.

In the case of small business, special rules apply. If a Contracting Officer finds a small business which offered the lowest price to be 1-705.4

nonresponsible, the case must be referred to the Small Business Administration (SBA). SBA reviews the findings and makes its own determination as to whether or not the small business is responsible. If it does find the small business responsible, the SBA issues a Certificate of Competency to the Contracting Officer. Except in some unusual circumstances, the Contracting Officer must abide by the SBA's decision and award the contract to the small business firm which offered the lowest price.

Third, the type of contract issued must be appropriate for the particular procurement. The DAR authorizes the use of several different types of contracts and describes the circumstances appropriate for the use of each. The type of contract used in each procurement should be determined by the circumstances of the procurement and the degree of risk associated with performance of the contract.

3-401

Fourth, the defense procurement program is used to implement various national social and economic policies. Some policies are implemented by mandatory contract provisions, such as those which require that minimum standards for wages, hours, and working conditions be met in producing supplies or performing services under a DoD contract. Other policies are furthered by laws requiring contracts to be awarded to certain contractors or prohibiting their award to others. For example, certain items must be purchased from Federal Prison Industries, Inc., and contracting with a company convicted of violating air pollution standards is prohibited. A third method of implementing national policies is the use of special procurement techniques, such as set-asides for both small businesses and firms located in labor surplus areas.

Section XII

5-402

1-2301

1-706

1-804

4. CONTRACT FORMATION

CONTRACTING OPPORTUNITIES

DAR
REFERENCE

DoD enters into millions of contracts each year. The DAR mentions several methods of assuring that all prospective contractors are aware of contracting opportunities. The most common ways in which DoD alerts prospective contractors to its requirements are notices in the Commerce Business Daily (CBD) and use of Bidders Mailing Lists (BMLs).

One way to find out about contracting opportunities is to read the CBD, which is published every weekday by the Department of Commerce. The DAR requires virtually every proposed unclassified procurement over \$10,000¹ to be publicized in the CBD. Information on subcontracting opportunities must also be published. This includes the names and addresses of firms to be solicited for major procurements and synopses of all unclassified contract awards over \$100,000. In addition, advance notice of a procuring agency's interest in a given field of research and development must be publicized in the CBD to encourage contractors to submit unsolicited proposals.

1-1001
thru
1-1007

A second way to find out about prime contracting opportunities is to be included on a BML of a contracting activity likely to have a need for your product or service. The DAR requires purchasing activities to establish and maintain lists of prospective suppliers. U.S. Government Standard Form 129, "Bidders Mailing List Application," should be submitted to each purchasing activity with which you hope to do business. The activity is required to notify you of your acceptance or rejection for the BML. When your name is placed on a BML, solicitations for requirements will automatically be issued to you. However, you must respond to each solicitation by either a bid, an offer, or a request for retention on the list; otherwise your name may be deleted. When the BML is extremely long, the purchasing activity may use only a portion of it. However, in these situations, the DAR requires that a pro rata number of small businesses be solicited.

2-205

¹At this writing, DoD has requested Congress to raise this amount to \$25,000.

A less common way to find out about contracting opportunities is to be included on a Qualified Products List (QPL). Such lists are used only for relatively simple products which require lengthy or costly testing to determine if they meet the Government's requirements. The QPL for each product identifies the specification and the manufacturer or distributor of each qualified item. When there is a need to procure a product for which a QPL exists, bids or proposals are usually accepted only for products on the list. To have your product listed on a QPL, you must submit a sample to the appropriate office for testing and acceptance.

Information about subcontracting opportunities is provided by DoD's "Small Business Subcontracting Directory." This publication is issued annually by the Directorate of Small and Disadvantaged Business Utilization. It lists, by state, the DoD prime contractors which have established plans and goals for subcontracting with small business and small disadvantaged business. For each contractor the directory provides the address, the product or service line, and the name and telephone number of the company's small business liaison officer.

Small high-technology firms should become familiar with DoD's Small Business Innovative Research (SBIR) programs. DoD has a specific annual goal for participation by small business in its SBIR. Under this program, each year DoD publishes solicitations that describe the research and/or development needs of DoD to be awarded through the SBIR program. Small, high-technology firms can submit proposals for research projects and DoD makes awards on a competitive basis. Selection criteria are included in each solicitation. For each project, Phase I awards of up to \$50,000 are made to evaluate the scientific and technical merit and feasibility of an idea. Those projects showing the most potential in Phase I can be funded for up to \$500,000 and one or two years to further develop the proposed ideas. Thereafter, private sector investment or DoD production contracts are expected to bring an innovation to the marketplace. The Phase I master program solicitation release schedule for all Government agencies is published annually by the SBA.

Sometimes you can create your own contracting opportunities by submitting unsolicited proposals. These are written offers to perform a task or effort which you initiate and submit to the Government. Unsolicited proposals are a valuable means of making unique or innovative methods available to the Government.

The DAR provides general guidance for submitting unsolicited proposals. Informal contacts with agency personnel are a good means of learning about an agency's mission and specific needs. An unsolicited proposal should contain an abstract of the proposed effort, the method of approach, and the extent of the effort. It should also include a proposed price or estimated cost. You should clearly mark any proprietary data which you wish to protect. 4-906

The DAR authorizes negotiated noncompetitive procurement on the basis of a favorable unsolicited proposal. It also requires that offerors of unaccepted proposals be notified of the reason for non-acceptance.

Certain factors limit DoD's ability to contract with small businesses. Vast amounts of facilities and working capital are required to produce major weapon systems. In many cases, even the resources of large businesses can be strained by performance and cost risks. To offset the potential ill effects of these and other factors on small business contractors, DoD has implemented a major program to place a fair proportion of its contracts with small businesses. Its activities to promote maximum small business participation include: 1-702

- seeking additional qualified small business suppliers
- including all qualified small business suppliers on BMLs
- permitting bidding on less than the total requirements
- allowing the maximum time possible for bid preparation
- assigning Small and Disadvantaged Business Utilization specialists to each principal contracting activity and contract administration office
- making provision for SBA representatives at all major procurement offices

- measuring and publicly reporting the extent of small business participation in defense contracts
- setting aside certain procurements for award only to small businesses
- contracting directly with the SBA for subcontracting with small disadvantaged businesses in the SBA's 8(a) portfolio
- encouraging large DoD contractors to subcontract with small businesses, small disadvantaged businesses and small women-owned businesses

The small business set-aside is a major procurement practice which DoD uses to promote small business participation. Contracting Officers must set aside procurements solely for small businesses whenever there is a reasonable expectation that two or more small businesses can provide the required supplies or services and that an award can be made at a reasonable price. This is called a total set-aside. Certain classes of procurements (for example, all purchases under \$10,000² and construction contracts under \$2 million) are automatically set aside for small business awards. Contracting Officers must justify in writing any failure to award such procurements to small business. Once a product or service has been successfully purchased as a small business set-aside, all future purchases must also be on a set-aside basis unless this practice fails to produce a satisfactory product, delivered in the time required at a reasonable price. Total small business set-asides may be accomplished by either formal advertising or negotiation. All applicable procurement procedures are followed. 1-706.1

Sometimes a procurement is not suitable for a total set-aside, but is large enough to be divided into two or more economic production lots. If it is likely that a small business can furnish one or more lots at a reasonable price, the DAR requires a partial set-aside. Under a partial set-aside, a portion of a requirement is set aside for award to small business. Any business (large or small) can compete for the non-set-aside portion. The reasoning is (1) to allow the competitive process to determine a reasonable price for the non-set-aside portions, 1-706.2

²At this writing, DoD has requested Congress to raise this amount to \$25,000.

and (2) to give small businesses the opportunity to contract for the set-aside portion at the same price.

The SBA has the authority to contract directly with DoD for supplies or services and then to subcontract the work totally to small disadvantaged businesses. These transactions are called 8(a) contracts, (named for the section of the Small Business Act which authorizes them). 1-705.5

The objectives of the 8(a) program are: (1) to foster business ownership by socially and economically disadvantaged individuals, and (2) to give such businesses opportunities for full participation in the free enterprise system. To participate in the 8(a) program, a small disadvantaged firm must receive SBA approval of a business plan for attaining the above objectives. In cooperation with DoD's small and disadvantaged business utilization specialists, the SBA identifies the supplies or services which 8(a) companies can provide. If feasible, DoD contracts for these supplies and services with SBA. SBA, in turn, subcontracts with the 8(a) company. If the costs for the supplies or services are in excess of DoD's estimated current fair market prices, the excess must be funded by the SBA.

Because much of DoD's contracting is for major weapon systems, great emphasis is placed on providing subcontracting opportunities for small businesses. Virtually every DoD contract over \$10,000 contains a clause committing the contractor to use small firms to the fullest practicable extent. Before a contract over \$500,000 (\$1 million for construction) can be awarded to a large contractor, a plan must be submitted showing how the contractor intends to meet subcontracting obligations to small businesses and to small businesses owned and controlled by socially and economically disadvantaged individuals. The DAR requires that actual performance under these plans be reviewed by the Contracting Officer. It also sets forth sanctions against contractors who fail to comply with such plans. 1-707

CONTRACTING PROCEDURES

Formal Advertising

Formal advertising is a very rigid process designed to protect the integrity of the competitive bidding system. Although it

consists of procedures that must be strictly followed, the courts, the Comptroller General, and the Board of Contract Appeals have created many precedents for interpreting certain aspects of the process. These precedents are far too numerous and specialized to be covered here. The information in this section should be considered general guidance only.

Procurement by formal advertising begins with the issuance of an Invitation for Bids (IFB), which contains all the information bidders need to respond. The IFB states the needs of the procuring activity and defines the work in sufficient detail to permit all bidders to compete on the same basis. Prospective bidders are provided standard forms on which to submit bids, and a specific time for opening the bids is established. 2-201

When necessary, the IFB may be modified by the Government before the bid opening. Once issued, an IFB may be cancelled only when cancellation is clearly in the public interest, for example, when the supplies or services are no longer needed. 2-208
2-209

Interested firms respond to the IFB by submitting sealed bids, which are stored unopened in a locked box or safe until the time set for opening. Bid opening is designed to ensure secrecy of the bids up to the time of opening and to prevent manipulation by the bidders. The opening is held in public, at the time specified in the IFB, and each bid is read aloud. As a general rule, late bids (those received after bid opening time) may not be considered for award. 2-401
2-402

The contract is awarded to the responsive and responsible bidder whose bid is most advantageous to the Government. Unless other factors are identified in the IFB, award is based on price only. Prompt payment discounts are not considered in evaluation of offers. The actual award must be made within a time specified in the IFB, usually 60 days from the opening date. 2-301
2-407.3

To be considered for award, your bid must be responsive. To be responsive, the bid and any modifications to it must be where the bids are to be opened before the time set for the opening. It must be on the bid form (or must repeat every essential provision of the bid form) and must offer what is called for in the IFB. Individual

bids will be rejected as nonresponsive if they fail to meet any essential requirement of the IFB. If a bidder takes exception to any material provision of the IFB, such as offering a different product or delivery schedule or refusing to accept a contract provision, the bid will be judged nonresponsive and will be rejected. However, bidders must be given the opportunity to correct any minor failure to comply with the IFB, such as failure to make the required representation regarding size of a firm.

2-405

Mistakes in bids occur frequently. A bidder may change or withdraw a bid (and thereby correct any mistakes) at any time before the opening of the bids. After the opening, Contracting Officers must examine all bids for mistakes. Obvious clerical mistakes in a bid may be corrected before award of a contract. Treatment of other mistakes found after opening, but before award, depends on the circumstances. In all cases, the evidence available to support the claimed mistakes must be reviewed by a senior official of the purchasing activity. The official may require that a bid stand as submitted or, if appropriate, may allow a bidder to correct or withdraw a bid. After award of a contract, relief from a bid mistake must be handled as a claim in accordance with the disputes clause included in every contract. Legal assistance should probably be sought for any case other than that of an obvious clerical mistake.

2-406

1-314(f)
and
7-103.12

Any bidder has the right to protest the proposed or actual award of a contract if it appears that an improper procedure was followed. Protests should be made in writing. You may submit a protest to the Contracting Officer or higher authority in the procuring activity, or to the Comptroller General of the United States. A successful protest can result in a change in the planned award or in cancellation of an award already made.

2-407.8

Two-step formal advertising is a procurement method conducted in two phases. It is used when the product or service desired cannot be adequately defined by Government specifications alone, or when alternative designs to meet a given need are desired.

2-501

In Step 1, technical proposals are solicited. Those received are evaluated as (1) acceptable, (2) susceptible of being made

2-503

acceptable, and (3) unacceptable. If there are enough Category (1) proposals to ensure adequate competition, the Contracting Officer proceeds to Step 2, in which IFBs are sent only to the firms which made acceptable proposals. Each firm submits a bid price covering its own technical proposal, and the award is made to the lowest bidder.

If there are not enough Category (1) proposals, those in Category (2) are discussed with the proposers in an attempt to make them acceptable. If this process results in enough acceptable technical proposals to ensure adequate competition, Step 2 is followed. If not, the formal advertising process ends, and negotiated contract procedures are followed with the firms that submitted acceptable technical proposals. In extreme cases, the solicitation may be cancelled.

Negotiation

When formal advertising is not possible, DoD purchases are negotiated. The DAR lists 17 circumstances where negotiated procurement is authorized. These include classified purchases, purchases of not more than \$25,000, and purchases of research and development efforts, as well as a general category called "impractical to secure competition by formal advertising." Approximately 90 percent of the total dollar value of DoD's contracts are placed through negotiation.

3-201
thru
3-217

The DAR requires negotiated procurements to be as competitive as possible. When price competition is adequate, negotiated contracting procedures are almost identical to those used in formal advertising. When competition is lacking, alternative procedures are used to assure reasonableness of price.

1-300.1

Procurement by negotiation generally begins with the issuance of a Request for Proposals (RFP) or a Request for Quotations (RFQ). The RFP, like the IFB, is a request for offers. This document is normally used when the contract terms and specifications are definite and there is likely to be enough competition to make an award to the most favorable offeror without any discussion or negotiation. When you submit your completed RFP, you make an offer to DoD. DoD may accept your offer without change by issuing a Notice of Award. This offer and acceptance creates a binding contract between you and DoD. When there is insufficient competition, or when clarifications of

3-501

3-805.1

the RFP are necessary, discussions and negotiations may take place and result in significant changes between the RFP and the contract.

The RFQ is simply an invitation to prospective contractors to enter into negotiations. It sets forth the terms and specifications desired by the Government. It differs from the RFP in that your response does not constitute an offer. 3-501

The regulations for RFPs are almost the same as those for IFBs. A standard form is used, and a specific date for submission of offers is established. Although RFPs are not opened publicly, proposals or modifications of proposals received after the deadline generally may not be considered. The rules for protesting awards and correcting mistakes are almost identical to those for formally advertised procurements. 3-506
3-509
3-805.5

If the most favorable proposal submitted in response to an RFP is accepted without any discussion, written or oral, with any offeror, a Notice of Award is sent to that offeror, creating a binding contract.

If discussions or negotiation with any offeror are necessary, the law requires the Contracting Officer to conduct written or oral discussions with all responsible offerors whose proposals are within a competitive range. The competitive range is determined by the Contracting Officer. It must include all proposals with a reasonable chance of being selected for award, considering price or cost, technical, and other pertinent factors. The discussions may not disclose any information about competing proposals or the relative standing of an offeror's prices, but they may indicate any deficiencies in a proposal or too high a price. At the conclusion of discussions, all offerors are notified in writing of a final date for submission of best and final offers. Award is made to whoever submits the most favorable offer. 3-805.1
3-805.2
3-805.3

Every negotiated procurement requires some form of price or cost analysis to establish the reasonableness of the contract price or cost. Price analysis can be accomplished by comparing quoted prices with (1) other offers, (2) prior prices, (3) established price lists, or 3-807.1
3-807.2

(4) Government estimates of reasonable prices. Price analysis is generally used in the purchase of competitive items, commercial items, or relatively small-dollar-value items.

When price analysis alone is not sufficient, DoD uses cost analysis to establish the reasonableness of contract price or cost. Cost analysis is an examination of each cost element in a proposal to determine whether the amounts are appropriate and reasonable. The data used to prepare the proposal form the basis for cost analysis. 3-807.2

For any noncompetitive contract or contract modification over \$500,000, the Contracting Officer is required by law to obtain from the prospective contractors the cost or pricing data used to support their proposals. The contractor must also certify in writing that these data are accurate, complete, and current at the time of agreement on contract price. There are similar requirements for noncompetitive subcontracts over \$1 million or \$500,000 if that sum is greater than 10 percent of the contract price. Both prime contracts and subcontracts must contain clauses entitling the Government to appropriate price or fee reductions should the cost or pricing data subsequently be found to have been inaccurate, incomplete, or non-current. 3-807.3 7-104.29

DoD uses profit to stimulate efficient contract performance. The DAR contains guidelines for developing profit and fee objectives prior to entering negotiations. Contracting Officers are directed to establish profit objectives prior to conducting contract negotiations. These objectives should provide the opportunity to earn profits while motivating contractors to undertake difficult work, provide their own facilities and financing, perform independent development work, and increase productivity. A technique called the weighted guidelines is used, which balances these factors in establishing negotiation objectives. You should be familiar with this technique, since it directly affects your negotiations. 3-808 3-808.2

The Armed Services Procurement Act limits fees (profit) which may be paid under cost-plus-fixed-fee type contracts to: 3-405.6

- (1) 15 percent of estimated cost for experimental, developmental, or research work;

- (2) 6 percent of estimated cost for architectural or engineering services relating to public works or utility projects;
- (3) 10 percent of estimated cost for all other types of work.

Small Purchases

Small purchases are those which do not exceed \$25,000. DoD uses simplified procedures for making these purchases. They include simpler contract forms and fast payment procedures. For purchases of \$1000 or less, the Contracting Officer must verify the reasonableness of prices only if he knows or suspects the quoted price is unreasonable. For purchases between \$1000 and \$25,000, the general rule is that competitive quotations are solicited orally from potential suppliers in the local trade area. Written solicitations are used when suppliers are outside the local trade area, when special specifications or a large number of different items are involved, or when oral quotes are otherwise impractical. Reasonableness of price is generally determined by the competitive process.

3-604

For repetitive purchases of small quantities of supplies or services, a blanket purchase agreement (BPA) is used. A BPA is much like a charge account. The agreement is issued on DD Form 1155, "Order for Supplies/Request for Quotation," which contains general terms and conditions. Usually BPAs are placed with two or more suppliers of the same type of item. Orders are generally placed orally, and payments are made monthly on a summary invoice submitted by the contractor.

3-605

DoD also uses DD Form 1155 as a purchase order form for non-repetitive small purchases. When necessary, additional clauses are added to the printed form. Oral or written quotations are solicited, as appropriate. Reasonableness of price is established through the competitive process. Form 1155 is also used as the public voucher (invoice) for payment in all small purchases.

3-608

The fast payment procedure is authorized for use in all purchases of less than \$25,000. It provides that suppliers may submit their invoices for payment as soon as the supplies are delivered to a

3-606

post office or common carrier or to the Government. The supplier must agree to replace or repair any supplies that are damaged, defective, or not actually received by the Government.

5. THE CONTRACT

CONTRACT TYPES

DAR
REFERENCE

DoD uses two basic contract types: fixed-price and cost-reimbursement. Cost-reimbursement contracts place very little risk on the contractor, while fixed-price contracts may involve substantial risk.

Fixed-Price Contracts

Under a fixed-price type contract, you must perform the work regardless of what it costs you. You should be very careful in pricing such work. You should take into account potential cost increases due to inflation, material shortages or difficulties in meeting performance requirements. This is particularly important if your contract contains options. Options give the Government the right to require you to perform, at stipulated prices, additional work which may extend your performance over a long period of time.

The firm fixed-price contract is the most common type -- the price is firm for the duration of the contract and is not subject to any adjustment, except for authorized changes. Under this type of contract, you assume the maximum risk of profit or loss, including the risk of unexpected costs such as those which might result from inflation, material shortage, etc. 3-404.2

DoD uses firm fixed-price contracts when costs are reasonably predictable, and when adequate design or performance specifications are available. They are particularly suitable for standard or modified commercial items and previously purchased military items.

Some fixed-price contracts contain economic price adjustment clauses. These clauses protect you and the Government against wide fluctuations in labor or material costs when market conditions are unstable. Economic price adjustment clauses may provide for adjustment of the contract price for increases or decreases from an agreed-upon level measured against: 3-404.3

- (1) published or established prices of specific items,

- (2) specified costs of labor and material actually experienced during performance, or
- (3) specified labor or material cost standards or indices.

You are entitled to a price adjustment (or required to make a refund) only if there is a change in the price levels specified in the contract. Frequently, the contract will contain a ceiling price that the Government will not exceed, no matter what the cost fluctuations may be.

Under a fixed-price redetermination type contract, you and the Contracting Officer establish an initial price, a ceiling price, and a time for redetermination. At the time of redetermination, you submit a proposal based on actual costs of performance and the estimated cost of any incomplete work. After a Government audit, you negotiate a revised price. The revised price may be higher or lower than the initial price, but may not exceed the ceiling price. 3-404.5
3-404.6

A fixed-price incentive type contract is similar to a redetermination contract. The difference is that a fixed-price incentive contract contains a target cost, a target profit, and a formula by which you and DoD will share any differences between target costs and negotiated final costs. The formula rewards you with more profit if final costs are less than the target cost, and it takes profit away if final costs exceed the target. For example, a typical sharing arrangement would be one whereby DoD would keep 80 percent of the savings and pay you the remaining 20 percent. Likewise, if final costs were higher than the target cost, DoD would pay 80 percent of the excess costs, and you would have to bear 20 percent of the excess costs as a reduction of profit. An infinite variety of sharing arrangements is possible, but you must remember that you cannot be paid more than the ceiling price. 3-404.4

Cost-Reimbursement Contracts

Under a cost-reimbursement type contract, DoD reimburses you for the actual cost of performance. You are paid your costs no matter what you have produced, and you are required to perform only as long as the contract provides money to pay you for costs incurred. However, you can only be reimbursed for costs in accordance with the 3-405.1

provisions of Section XV of the DAR. There are several different cost-reimbursement type contracts, but all have this common feature: your obligation to perform the work ceases when your costs of performance equal the funds provided under the contract.

The most common type is the cost-plus-fixed-fee contract. 3-405.6
You and DoD agree on the estimated cost of contract performance and a fixed fee (profit) that you will receive for doing the work. You will receive the same fee, regardless of whether your actual costs are greater or lesser than the estimated cost.

Under the cost-plus-incentive-fee type contract, you and the 3-405.4
Contracting Officer agree on a target cost, a target fee, and an incentive formula for determining the final fee. The formula provides for an adjustment in the fee, based on any difference between the target cost and the actual cost of performing the contract. Unlike the fixed-price incentive contract, however, the contract will provide both a minimum and maximum limit on the fee adjustment.

The cost-plus-award-fee contract is another cost- 3-405.5
reimbursement type contract. The fee consists of (1) a base fee (which cannot exceed 3 percent of the target cost) which does not vary with performance and (2) an award fee. The award fee paid varies according to the Contracting Officer's evaluation of performance in such areas as quality, timeliness, ingenuity, and cost effectiveness.

Another contract frequently used by DoD is the time and 3-406.1
materials contract. Under this type of contract, you negotiate a fixed hourly rate for direct labor. This rate includes all appropriate wages, overhead, and profit. You are reimbursed at the fixed rate for each labor hour worked on the task. Any material costs incurred in performing the work are reimbursed at cost. The time and materials type contract is used when it is not possible to estimate the extent of the work, especially in cases of repair, maintenance, or overhaul work.

PARTS OF THE CONTRACT

A contract has two major parts: the "Schedule" and the "General Provisions" (also known as the "boilerplate").

The Contract Schedule

DAR
REFERENCE
3-501

The Schedule is tailored to each transaction and represents the substance of the deal. It includes a statement of the work to be done or the supplies to be furnished, the price, the specifications, the delivery schedule, and any special conditions. Different items being purchased are listed separately as contract line items. Every DoD contract uses a uniform numbering system for line items. This means that the first item listed in a Schedule will be Item No. 0001. 20-303

The list of supplies or services is followed by the specifications or other descriptions to which the work must conform. Careful reading of the specifications is essential, because many of them refer to other requirements, generally known as referenced documents. You must comply with all contract requirements, including any referenced documents, to complete the contract satisfactorily.

The delivery section of the Schedule specifies the time, place, and method of delivery for supplies, or the place of performance of services. For relatively small products, especially those purchased by formal advertising, the contract usually provides for delivery to specified destinations. Larger items are generally inspected and accepted at the contractor's plant and then shipped on Government Bills of Lading (GBLs). Special attention must be given to the delivery point stipulated in IFBs, since offers submitted on a basis other than that called for in the IFB must be rejected as nonresponsive. 19-104 2-404.2

Finally, the Schedule contains any special provisions applicable to the specific contract. Examples include use of Government-owned property, options for additional quantities of supplies, and special test procedures.

General Provisions

The General Provisions or boilerplate of DoD contracts consist mainly of clauses required by statute or regulation. Deviations from the requirements involve tedious procedures and are the exception rather than the rule. A formally advertised contract is similar to an insurance policy in that you have no control over the 1-109

clauses included. In a negotiated contract, however, you may be able to influence some of the terms.

The DAR contains over 500 pages of contract clauses, and it would be impractical to cover every one of them in this guide. Fortunately, many clauses cover similar topic areas. We have arranged these areas in six major groups: performance, payments, contract cost principles, contract changes, terminations, and public policies. Section VII

Certain clauses in the boilerplate require particular attention because they expose you to many of the peculiarities associated with Government contracting. These provisions have little or no counterpart in commercial dealings. They relate to changes, disputes, terminations, patent rights, examination of records, Government inspection, and correction of defects.

Performance

DoD has many procedures and clauses which affect your performance of a contract. While performing the contract, you may face issues such as DoD inspection and acceptance, subcontracts, use of Government property, patents, data and copyrights, and bonds, insurance, and taxes. In addition, every DoD contract contains a provision for resolving disputes that may arise under the contract.

Inspection and Acceptance. As a contractor, you are responsible for delivering products or providing services on schedule and for assuring that they conform to contract requirements. The contract administration office is responsible for assuring that you fulfill your contract quality requirements. The Government may conduct inspections and tests to determine if the goods are in conformity. The type and extent of inspection and testing depend largely on what is being procured. The contract will designate the place of inspection. If the goods are to be shipped from the plant before they are accepted, the contract will contain a clause which assigns the risk of loss if the goods are damaged in transit. 14-102
14-203
14-103
14-305
7-103.6

Generally, when each delivery is made, the contractor must prepare and submit a Material Inspection and Receiving Report (DD Form 250). This lists the goods delivered, quantities, contract

number, and other necessary information. You may obtain copies of DD Form 250, at no cost, from the contract administration office. If the contract contains a fast payment procedure, you may submit your invoice in lieu of a Form 250.

3-606

While there are many versions of the inspection clause, certain uniform features can be noted. The standard clause used in fixed-price contracts provides that items to be delivered under the contract are subject to inspection and test by DoD before acceptance. DoD has the right to reject nonconforming items, have the defects corrected at the contractor's expense, or accept the nonconforming items at a reduced price. Acceptance by DoD is final, except as regards hidden defects or fraud.

14-302

7-103.5

You are required to provide facilities for, and assistance to, DoD inspectors at your own expense. You must also maintain an acceptable inspection system. You are also responsible for providing appropriate quality assurance controls. If the Government inspection or test is made somewhere other than on your premises or those of your subcontractor, it is at DoD's expense. The inspection and test must not unduly delay your work.

7-103.5

The clause governing inspection and correction of defects in cost-reimbursement contracts differs from the standard fixed-price clause in two major respects. First, nonfraudulent defects are corrected at DoD's expense. Second, the Government may require the contractor to remedy any defective items within six months of acceptance.

7-203.5

Subcontracts. Subcontracts affect the price and performance of prime contracts. DoD frequently requires that you obtain the Contracting Officer's consent to proposed subcontracts. The DAR requires prime contractors to select subcontractors and suppliers on the most competitive basis possible. The terms and conditions of a subcontract generally are subject to negotiation between the subcontractor and the prime contractor. However, the DAR does stipulate certain mandatory provisions in subcontracts.

7-104.23

7-203.8

23-201

7-104.40

In many instances, subcontractors must furnish complete, current, and accurate cost or pricing data to the prime contractor.

3-807.4

7-104.42

DoD reserves the right to reduce a prime contractor's price because of a subcontractor's defective data. If a prime contractor suffers such a reduction, the subcontractor may have to reimburse the prime contractor.

Government Property. In general, you must furnish all the property required to perform your contract. However, sometimes your contract may require DoD to supply you with Government property.

Government property can be either Government-furnished or contractor-acquired. Government-furnished property is property the Government possesses or acquires directly and then makes available to a contractor. Contractor-acquired property is property a contractor provides for the performance of a contract, to which the Government has title. 13-101

Government property includes materials, special tooling, special test equipment, and facilities. Materials are property that may be incorporated into an end item to be delivered under the contract or consumed in the performance of a contract. Special tooling and special test equipment are manufacturing aids designed for use in production and test of the product being produced under the contract. Facilities are industrial property (other than material, special tooling, and special test equipment), including real property, buildings, and other structures. 13-101

As a rule, the Government assumes the risk of loss or damage to its property. In competitive procurements, however, the contractor assumes liability for this risk. 13-102

You may use the Government property in your possession only for its intended purpose. Use for any other purpose must be approved by the Contracting Officer. If DoD furnishes property which is unsuitable for its intended use or which creates production difficulties resulting in extra costs, you are entitled to an appropriate price adjustment. 7-104.24
7-104.25
7-104.26

Contractors already possessing Government property suitable for use in an upcoming award could have a competitive advantage. To eliminate any such advantage, DoD applies evaluation or rental factors when reviewing bids and proposals. 13-501
thru
13-506

Appendix B of the DAR sets forth requirements for contractors to follow in establishing and maintaining control over Government property. The appendix deals primarily with record-keeping, control of scrap and salvage, identification requirements, and the contractor's duties and responsibilities with respect to the property.

Patents, Data, and Copyrights. Patents, data, and copyrights are generally grouped together for discussion purposes. They are often described as "intellectual property." There are two aspects of this type of property which are pertinent to DoD contracting: (1) the determination of who receives title to property developed in the course of performing a DoD contract, and (2) the right to use existing property.

Section IX

If a purpose of a contract is the performance of experimental, developmental or research work, the contract will contain a Patent Rights clause. It is DoD policy that small business firms, whether acting as prime contractors or subcontractors, should retain title to any invention conceived or first reduced to practice in performance of work under DoD contracts. The Government retains an irrevocable, nonexclusive, royalty-free license to practice or to have such inventions practiced on its behalf. You must disclose any such invention to the Contracting Officer. You may forfeit title to the invention if you fail to disclose it. You may elect not to retain title to an invention in which case the Government may assume title and provide you with a royalty-free license thereunder.

9-702

7-302.23(h)

The standard practice with respect to existing patent rights is to include an "authorization and consent" clause in every contract. The clause authorizes you to use any invention patented by others in the United States. Its purpose is to prevent disruption of contract performance by court injunctions against patent infringement. In the event of an infringement, the patent owner must sue DoD rather than you.

7-103.22

7-302.21

The authorization and consent clause does not mean that DoD necessarily accepts final liability for a patent infringement. In fact, most contracts contain a patent indemnity clause, which requires you

7-104.5

to reimburse DoD for claims paid due to patent infringement. You are required to notify DoD of any infringement claims arising from the performance of your contracts and to assist the Government in its defense against such claims. 7-103.23

DoD's policy is to acquire only those technical data rights necessary to meet its needs. The term technical data means recorded information of a scientific or technical nature. It does not include computer software, financial, administrative, cost or pricing, or other important data. 9-202.2
9-201

DoD acquires unlimited data rights if the data are developed at public expense and identified as a contract requirement. Unlimited rights allow DoD to use the data for any Government purpose, including follow-on work with other contractors. 9-202.2
7-104.9

If the data are developed at private expense, DoD obtains limited rights. This means DoD may use, duplicate, or disclose the data only for internal Government purposes. Such data may not be released outside the Government except in certain emergencies. 9-202.2
7-104.9

DoD policy on computer software generally parallels that on technical data. DoD acquires unlimited rights to software developed directly under or as a necessary part of a contract. Software developed at private expense may be acquired with limited use rights, that is, for any internal Government purpose. Software supplied with a specific computer may be acquired with restricted use rights. It may generally be used only with the computer for which it was acquired. 9-600
7-104.9

In general, the copyright law gives the owner of a copyright exclusive rights to: 9-202.2

- (1) reproduce the copyrighted work in copies or phonorecords,
- (2) prepare derivative works,
- (3) distribute copies or phonorecords to the public,
- (4) perform the copyrighted work publicly, and
- (5) display the copyrighted work publicly.

Although a contractor may copyright data originated under a Government contract, the Government retains a nonexclusive, paid-up license to reproduce, translate, publish, and use these data.

Bonds, Insurance, and Taxes. Contracting Officers may require performance or payment bonds in appropriate circumstances. In practice, these bonds are generally not required, except in construction contracts. 10-104

Contractors are required to carry insurance under fixed-price type contracts only in special circumstances. Under cost-reimbursement type contracts, you are normally required to carry workmen's compensation, employer's liability, comprehensive general liability (bodily injury), and comprehensive automobile liability (bodily injury and property damage) insurance, with respect to the performance of the contract. 10-401
10-501

Contracts for research and development may provide for indemnification of you and your subcontractors against claims by third parties (including employees) for death, bodily injury, or loss for damage to property. The indemnification also covers your property to the extent such liability, loss, or damage results directly from an unusually hazardous risk and is not compensated by insurance or otherwise. 10-701

The tax aspects of Government contracting are many and varied. Only two basic points can be made here. First, you should include in your contract price all applicable Federal, state, and local taxes. Second, in some circumstances, the contract may include a price adjustment clause to compensate for increases or decreases in Federal excise or state and local taxes. Section XI
7-103.10

Disputes. Disputes between you and the Contracting Officer may occur under the contract. All contracts contain a disputes clause which presents the procedures to be followed in case of any unresolved disagreements between you and the Contracting Officer. You must state your position in writing to the Contracting Officer, who must respond with a written decision, including supporting reasons, and advise you of your appeal rights. Unless appealed within certain time limits, the Contracting Officer's decision becomes 1-314
7-103.12

final and not subject to review. You have 90 days from the date of an adverse decision by the Contracting Officer to appeal to the Board of Contract Appeals. The Board's decision is final, unless you appeal to the U.S. Court of Appeals within 120 days. Alternatively, you may elect to appeal a Contracting Officer's decision directly to the Court of Claims, provided you do so within 12 months of the date of the decision.

Remember that you are required to continue performance under the contract except when DoD breaches the contract.

Payments

One of the most important provisions of a contract deals with payments. Your contract will specify the DoD office responsible for payments and will also contain invoicing instructions. The time it takes to be paid is directly related to the accuracy of your invoices, so it is worthwhile to understand the payment process thoroughly. A clause entitled "Invoices" sets forth what must be included and is included in every contract. 20-706 7-103.20

DoD may help finance a contract if it is likely to make performance more prompt and efficient. To minimize the need for assistance, DoD emphasizes prompt payment on all contracts. This includes both DoD payments to prime contractors and prime contractor payments to subcontractors. If the Government fails to pay amounts due on valid invoices within the prescribed time limit, you may be entitled to interest on such amounts. E-201 1-314(m)

How you receive payment for your work depends on the type of contract you have. Payments under cost-reimbursement contracts are entirely different from those under fixed-price contracts.

Under cost-reimbursement contracts, you are reimbursed for the allowable costs you incur in performing the work. Any costs you incur which are not allowable under DoD's rules will be omitted from your payments. (See the following section for an explanation of allowable costs.) Every two weeks, or more frequently if warranted, you submit your invoice (or a public voucher form obtained from your DoD inspection office) for costs incurred. You can include the percentage 7-203.4

of your fee applicable to the incurred costs. After you have received 85 percent of any fee under a contract, the balance is withheld pending completion of the work.

Under fixed-price contracts, the method of payment can vary with the dollar value of the contract. For relatively small contracts with a single item of work, you will generally be paid the total contract price in one lump sum. Payment is made after you deliver the products or services and DoD accepts them. For larger contracts with many items, you can invoice and receive partial payments. For example, in a contract for 120 units with a delivery rate of 10 per month, you can invoice each month for the price of delivered (and accepted) items.

7-103.7

Under larger fixed-price contracts and subcontracts where the first delivery is at least four months after award, DoD recognizes your need for working capital. These contracts may contain a clause which will allow you to obtain progress payments monthly. Progress payments to small business are usually made at 95 percent of costs incurred. Payments upon delivery are adjusted to reflect previous progress payments.

E-503

7-104.35(b)

Even with progress payments at 95 percent of costs incurred, invoice processing time may cause your investment in work in process to exceed 5 percent. Under certain negotiated fixed-price contracts in excess of \$1,000,000, you may request flexible progress payments. This procedure allows the progress payment rate to vary between 95 percent and 100 percent of costs incurred as work progresses. Detailed cash flow analyses are required to demonstrate the need for flexible progress payments. The Contracting Officer will assist you in determining whether you need and qualify for flexible progress payments.

E-530

Because progress payments are an advance for work to be performed, you must repay them if you fail to complete the work. To protect its interest, DoD takes title to your work in process for which progress payments have been made.

7-104.35(b)

To qualify for progress payments, your accounting system must be able to accurately identify and segregate contract costs. To

receive progress payments, you submit a DD Form 1195 to your DoD Contracting Officer.

One word of caution regarding progress payments. If a competitive solicitation does not contain a progress payment clause, do not condition your bid or proposal on receiving progress payments. That would make your bid nonresponsive. Instead, you should request that the IFB or RFP be amended to add progress payments. 2-404.2

Payment provisions for contracts of \$25,000 or less can be quite simple. You submit an invoice which shows that the supplies have been delivered to a post office, common carrier, or the point of first receipt by the Government. You agree to replace, repair, or correct supplies not received at destination, damaged in transit, or not conforming to purchase requirements. When DoD receives the voucher, it pays you without waiting for actual receipt and acceptance of the supplies. 3-606 7-104.84

Contract Cost Principles

The DAR contains certain cost principles to be applied in the following situations: *Section XV*

- (1) pricing negotiated contracts,
- (2) reimbursements under cost-type contracts,
- (3) termination settlements,
- (4) price revision of redeterminable and fixed-price incentive contracts, and
- (5) pricing contract modifications.

In these situations, you cannot recover all costs incurred, but only those costs deemed "allowable."

To be allowable, an individual item of cost must be 15-201.2

- (1) reasonable,
- (2) allocable,
- (3) computed in accordance with generally accepted accounting principles and practices, and

- (4) consistent with any other limitation or exclusion set out in DAR or the contract.

A cost is reasonable if it does not exceed what would be incurred by an ordinarily prudent person in the conduct of competitive business. 15-201.3

Generally, a cost is allocable if it can be charged to a contract, product, product line, etc., according to the relative benefits received. Specifically, a cost is allocable if it 15-201.4

- (1) is incurred directly for the contract,
- (2) benefits both the contract and other work and can be distributed among all work in reasonable proportion to the benefits received, or
- (3) is necessary to the overall operation of your business.

The DAR does not discuss every type of cost. Approximately 50 selected items of cost are defined and designated as allowable or nonallowable. For example, depreciation of plant and equipment is an allowable cost; interest expense is nonallowable. Allowability of costs not explicitly covered by the DAR is based on the general principles stated above and on the treatment of similar or related cost items. 15-205

In any given contract, the reasonableness and allocability of certain items of cost may be difficult to determine. To avoid disallowances, you should seek advance agreement with DoD as to the treatment of these costs. The advance agreement should be negotiated before the costs are incurred. It is incorporated into cost-reimbursement contracts or made part of the file in the case of certain negotiated fixed-price type contracts. The advance agreement cannot allow treatment of costs inconsistent with the cost principles set forth in the DAR. 15-107

The DAR lists 12 specific cost items in which advance agreements may be particularly important:

- (1) compensation for personal services,
- (2) use charge for fully depreciated assets,
- (3) deferred maintenance costs,
- (4) precontract costs,

- (5) independent research and development costs,
- (6) royalties,
- (7) selling and distribution costs,
- (8) travel costs, as related to special or mass personnel movements,
- (9) idle facilities and idle capacity,
- (10) automatic data processing equipment,
- (11) bid and proposal costs, and
- (12) severance pay to employees on support service contracts.

Contract Changes

Because DoD's needs change frequently, every DoD contract contains a changes clause. The particular clause varies according to the type of contract, but all clauses have certain common elements.

A changes clause authorizes the Contracting Officer to order you to make changes "within the general scope of the contract." A change is within the scope of the contract if it can be regarded as fair and reasonable within the contemplation of the parties when the contract was entered into. This means that DoD cannot use a change order to change the nature of the contract. In supply contracts, the changes are limited to specifications (if the goods are specially manufactured for DoD), the manner of shipment and packing, and the place of delivery. If the change causes an increase or decrease in the cost of, or the time required for, the performance of any part of the work under the contract, an equitable adjustment will be made in the contract price or delivery schedule.

Generally, the Contracting Officer issues change orders in writing. Occasionally, something the Contracting Officer does (oral directions, for example) may have the effect of requiring you to perform work different from that prescribed by the contract. This may constitute a "constructive change" order and entitle you to relief under the changes clause. To obtain relief under the changes clause, you must submit your claim to the Contracting Officer within 30 days

of receiving a written change order, or within a reasonable period of time after receiving a constructive change order (usually 20 days).

You must proceed to perform the contract as changed, unless the change is beyond the general scope of the contract. If you fail to proceed under a proper change order, you are liable for breach of contract.

Terminations

The DAR requires that a termination clause be included in every contract. Termination clauses vary, but they are of two general types: default and convenience.

Terminations for Default. DoD may terminate all or part of a contract for default for any of the following reasons:

Section VIII
Part 6
7-103.11

- (1) you fail to make delivery within the time specified in the contract, *7-203.10*
- (2) you fail to make progress so as to endanger performance of the contract, or
- (3) you fail to perform any other provisions of the contract.

Before terminating a contract for default, the Contracting Officer must give you a written notice, called a "Cure Notice," of your failure. This notice allows you at least 10 days to cure any defects. In some cases, a "Show Cause Notice" rather than a Cure Notice will be issued. The Show Cause notice directs you to show why you should not be terminated for default. It ensures that you understand your predicament. Your answer can be used in evaluating whether circumstances justify default action.

Upon termination for default, you are entitled only to payment at the contract price for items accepted by DoD. Under a default clause, DoD has the right to repurchase the item elsewhere and charge excess (i.e., procurement) costs to you.

8-602.6

If you can show that your delay is excusable, you cannot be terminated for default. To be excusable, the delay must be beyond your control and not caused by your fault or negligence. Examples of

7-103.11

excusable delay include:

- (1) acts of God,
- (2) acts of the public enemy,
- (3) acts of Government,
- (4) fires,
- (5) floods,
- (6) epidemics,
- (7) quarantine restrictions,
- (8) strikes,
- (9) freight embargoes, and
- (10) unusually severe weather.

If you can prove that you have been improperly terminated for default, the termination will be treated as one for the convenience of the Government.

8-200
7-103.21
7-203.10

Terminations for Convenience. The DoD may terminate all or part of a contract for its convenience. This type of termination protects DoD's interests by allowing cancellation of contracts for products that become obsolete or unneeded. The termination does not arise from any fault on the part of the contractor.

As with terminations for default, DoD must give you written notice of termination for convenience. The notice of termination will usually direct you to do the following:

8-203

- (1) stop work,
- (2) terminate subcontracts,
- (3) place no further orders, and
- (4) communicate similar instructions to subcontractors and suppliers.

If you fail to follow these directions, you do so at your own risk and expense. You should also receive detailed instructions as to the protection and preservation of all property that is, or may become, Government-owned.

After termination, DoD is required to make a fair and prompt settlement with you. Generally speaking, settlement takes the form of a negotiated agreement between the parties. The idea is to agree on an amount that will compensate you fully and fairly for the work you have done and any preparation you have made for the terminated portion of the contract. A reasonable allowance for profit is also included. The settlement of cost-reimbursement type contracts is somewhat simpler than fixed-price type contracts, since you have been reimbursed on a cost basis from the beginning of the contract.

8-210

You are entitled to recover all allowable costs incurred in settling a termination for convenience. These may be costs for:

15-205.42

- (1) preparation and presentation of claims,
- (2) termination and settlement of subcontracts,
- (3) storage and disposal of Government-owned property, and
- (4) other termination activities.

DoD retains the right to approve or ratify any settlements made with subcontractors. When you and DoD agree to all or part of your claim for compensation as a result of the termination, a written amendment (known as a settlement agreement) is made to the contract.

8-209

8-210

Generally, termination halts regular payments to you under the contract. However, since you may have money tied up in finished and unfinished products, materials, and labor, most termination clauses provide you with interim financing through partial payments.

8-213

Public Policies

Other national goals, besides the promotion of small businesses, are reflected in DoD contract clauses. As a DoD contractor, you need to be aware of these additional requirements. We have grouped the clauses under six headings and summarized key points about each below. You should, of course, become more familiar with their specific requirements before entering into a contract.

Labor Standards. Under the Contract Work Hours and Safety Standards Act, all Government contractors who employ laborers

12-301

7-103.16

or mechanics are required to pay them one and a half times the basic rate for work in excess of 8 hours a day and 40 hours a week. This requirement also extends to all subcontracts.

Contractors receiving supply contracts over \$10,000 who are manufacturers of, or regular dealers in, the supplies must comply with the regulations issued by the Secretary of Labor under the Walsh-Healey Public Contracts Act. This Act governs minimum wages, maximum hours, and working conditions and prohibits the use of child and convict labor. In some cases, the Act does not apply to subcontracts.

Contracts not subject to the Walsh-Healey Act must include a provision prohibiting the use of convict labor. Contracts involving construction work must contain several additional clauses relating to construction industry labor standards. Contracts for services contain a clause required by the Service Contract Act. This clause stipulates minimum standards for wages, fringe benefits, and working conditions for service employees.

Labor Surplus. The Government encourages placing of contracts and facilities in areas of unemployment or underemployment. In all contracts which exceed \$10,000 (except those with foreign firms, or involving personal services, construction, or petroleum products), contractors must try to place subcontracts in accordance with this policy. If the contract exceeds \$500,000, the contractor must organize and carry out a program for placing subcontracts with firms located in areas of high unemployment or underemployment.

Equal Employment. The Government ensures equal opportunity for all qualified persons employed by, or seeking employment with, Government contractors, regardless of race, color, religion, sex, age, or national origin. Unless exempted by the Director, Office of Federal Contract Compliance Programs, all DoD contracts and subcontracts over \$10,000 must contain an equal opportunity clause. This clause obligates the contractor to ensure nondiscrimination in hiring, as well as in the terms and conditions of employment. If the contractor does not comply, the contract may be terminated.

Several other clauses mandate compliance with the equal opportunity standards. In contracts over \$1,000,000, bidders or offerors are subject to pre-award equal opportunity review to determine their eligibility for contract award. Bidders or offerors on a contract exceeding \$10,000 must certify that they maintain non-segregated facilities.

7-2003.14

Every contract and subcontract exceeding \$2,500 must contain a clause requiring the contractor or subcontractor not to discriminate against any employee or applicant for employment because of a physical or mental handicap, if that person is otherwise qualified for the position. Every contract or subcontract exceeding \$10,000 must contain a clause requiring the contractor or subcontractor not to discriminate against any employee or applicant for employment who is a disabled veteran or veteran of the Vietnam era, if that person is otherwise qualified for the position.

Section XII
Part 13

7-103.28

Section XII
Part 14

7-103.27

Preferred Products and Services. Many DoD contract clauses reflect public policies which require that preference be given to certain products or services. For example:

- U.S. private vessels shall be used for shipment of certain supplies.
- Contractors must purchase jewel bearings from domestic sources.

1-1402

1-2207.2

The most frequently encountered (and unfortunately, the most complex) preferred product procedures involve the Buy American Act. Under this Act, the Government favors domestic goods and services over foreign goods and services. A product is considered to be domestic if the cost of the domestic materials used in the product is over 50 percent of the cost of all materials used in the product. The Act provides that the Government may only use products made in the U.S. when it acquires goods and services, unless (1) the supplies or services are for use abroad, (2) domestic supplies or services of a satisfactory quality are unavailable in sufficient quantities, or (3) a domestic purchase would be either contrary to public interest or too costly.

Section VI
Part 1

When a Contracting Officer evaluates both foreign and domestic bids, the foreign bid is adjusted by either adding 50 percent of the bid exclusive of duty or adding 6 percent of the bid inclusive of duty, whichever results in a higher price. If the low domestic bidder is either a small business or a labor surplus area business, a 12 percent factor is used instead of 6 percent.

The requirements of the Act are waived when the Government purchases certain defense items from companies of NATO Alliance countries. It is also waived on U.S. purchases of certain products from countries with which the U.S. has trade agreements. Prospective contractors are advised in the IFBs and RFPs that information about exceptions under the Act is available upon request.

Section VI
Part 14

Section VI
Part 16
6-104.2

Sanctions for Improper Conduct. Several standard clauses protect the integrity of the Government procurement process.

1-111

The Officials Not to Benefit clause prohibits members of Congress or resident commissioners from participating in any share or part of the contract.

7-103.19

Anti-kickback provisions prohibit a subcontractor under any negotiated contract from paying any fee, commission, or compensation to any prime contractor or higher tier subcontractor as an inducement or acknowledgment for the award of a subcontract or order.

1-111.3

A contractor may not offer or give any gratuity (such as entertainment or a gift) to a Government employee to obtain a contract or favorable treatment regarding contract awards and determinations.

7-104.16

There is also a mandatory clause which requires the contractor to warrant that no persons, other than employees or established commercial or selling agencies, have been employed for the purpose of soliciting business upon a commission, percentage, brokerage, or contingent fee basis.

Section I
Part 5
7-103.20

The DAR prescribes sanctions against those who violate or otherwise fail to conform to the standards required of Government contractors. These sanctions consist of debarment, suspension, and ineligibility for award of contracts. Debarment is the most serious

Section I
Part 6

penalty. It generally results from conviction of a serious offense or willful violation of contract requirements and can last up to three years. Suspension is temporary, pending completion of investigation and legal proceedings. It is used when serious evidence of wrongdoing exists but has not been proven. Contractors are classed as ineligible if they do not qualify as "manufacturers" or "regular dealers" within the Walsh-Healey Public Contracts Act. DoD maintains a consolidated list of debarred, ineligible, and suspended contractors.

6. CONCLUSION

The DAR is the single most important regulation governing DoD procurement. This guide is not a substitute for any requirement or provision of the DAR. It is simply an introduction to defense contracting.

In this guide you have been exposed to those DoD policies and procedures most frequently encountered by small businesses. You are now aware of some of the major differences between commercial and Government procurement. You understand what a Government contract contains and how it is formed. Finally, now that you know the basics of defense contracting, you will find that doing business with DoD is not as difficult as you may have thought.

APPENDIX
ADDITIONAL SOURCES OF INFORMATION

MARKETING INFORMATION

"Selling to the Military"

Provides offices, addresses, and telephone numbers of major buying offices of the Army, Navy, Air Force, and Defense Logistics Agency with summaries of the procurement responsibilities and types of major purchases for each activity.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402 (Stock No. 008-000-00392-1), or may be obtained from nearest DoD Contracting Office.

"Commerce Business Daily"

A daily list of proposed procurements by the Federal agencies, estimated to exceed \$10,000³ and civilian agency procurements in excess of \$5,000. Also contains a list of subcontracting leads, sales of surplus property, and foreign business opportunities.

Subscriptions may be made through the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402.

"U.S. Government Purchasing and Sales Directory"

Provides a listing of products and services bought by all Federal agencies, keyed to the purchasing offices that buy them. Also provides information on Government sales of surplus property.

Available from nearest Small Business Administration office.

"Small Business Subcontracting Directory"

Provides company name and address, product or service line, and name and telephone number of company's small business liaison officer for DoD prime contractors that have plans and goals (set forth in their prime contracts) for subcontracting with small business and small disadvantaged business concerns. Published annually.

Available from the Small and Disadvantaged Business Utilization Specialist at the nearest military purchasing activity.

³At this writing, DoD has requested Congress to raise this amount to \$25,000.

"SBA Master Small Business Innovation Research Program Solicitation Release Schedule"

Each fiscal year the Small Business Administration will publish the list of topics upon which research effort will be sought by all major Government agencies. This list will include name, address and telephone numbers of agency contact points for the program, the estimated dates when solicitation will be issued and proposals required, together with the estimated number and average amounts of awards planned for that fiscal year.

Available from the U.S. Small Business Administration, SBIR, 1441 L Street, N.W., Washington, D.C., 20416.

"How to Obtain Consideration for Architect-Engineer Contracts With the Department of Defense"

Outlines policies governing selection of architect-engineers and describes procedures for obtaining consideration for architect-engineer contracts.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402 (Stock No. 008-007-02778-6), or may be obtained from nearest DoD Contracting Office.

"Handbook for Small Business: A Survey of Small Business Programs of the Federal Government"

Contains information on Government-sponsored loans and financial guarantees, management and technical assistance and programs, Government purchasing and sales programs, grants, and entering the world trade markets. Outlines design of Federal programs, describes each program and indicates how and where further information can be obtained.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402 (Stock No. 052-071-00600-1).

AIDS FOR SMALL BUSINESSES

"DoD Small and Disadvantaged Business Utilization Specialists"

On a nationwide basis, lists specialists by name, location, and phone number.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402 (Stock No. 008-000-00390-4), or may be obtained from nearest DoD Contracting Office.

"Procurement Automated Service System (PASS)"

The PASS matches key data about small businesses against requirements for future Government procurement to determine the most acceptable firms which may be asked to prepare a bid or proposal for the procurement.

To be listed in the PASS, contact nearest Small Business Administration office for SBA Form 1167. (Participation in PASS is free.)

"Management Aids"

Short papers providing specific guidance on various topics.

Available from nearest Small Business Administration office.

AVAILABILITY OF THE DEFENSE ACQUISITION REGULATION (DAR)

The Defense Acquisition Regulation is sold on a subscription basis. This subscription service, consisting of a basic set of loose-leaf pages plus additional material published as Defense Acquisition Circulars, is priced at \$115.00 (\$143.75 for foreign mailing).

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